

Implementation of IFRS in Europe: Status, Challenges and Perspectives

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IFRS in Europe: Main messages



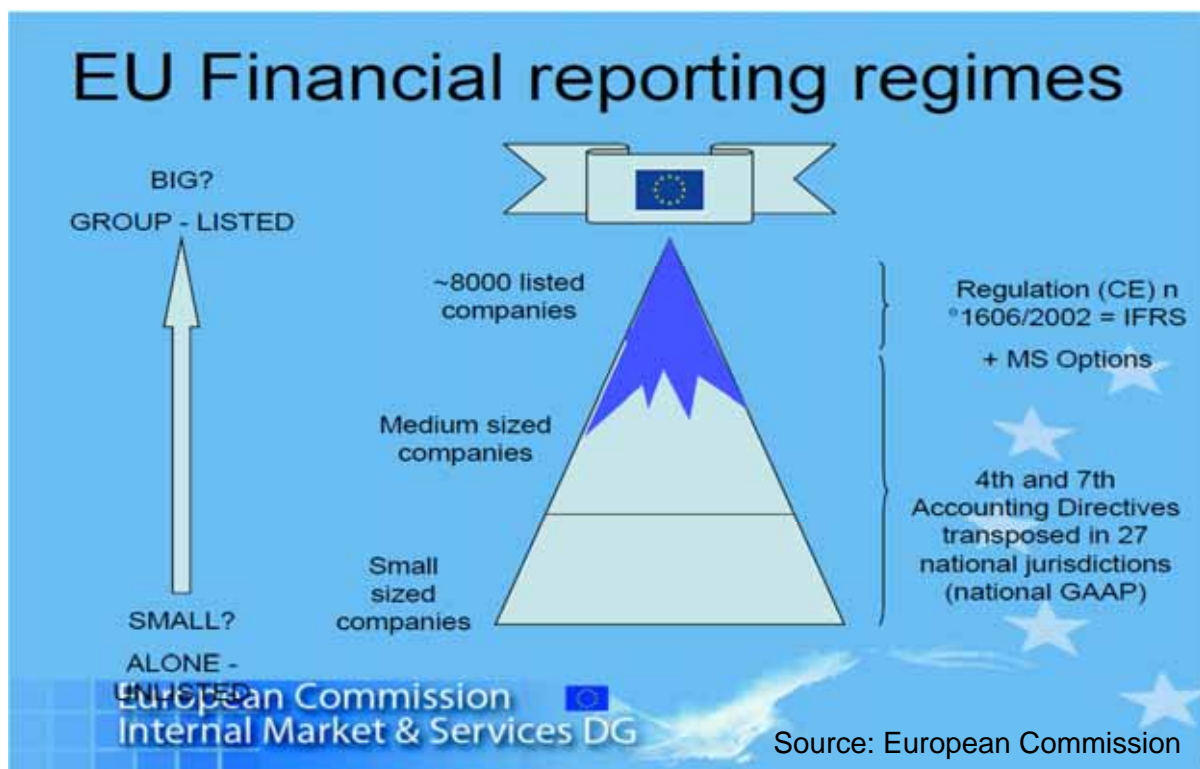
- » **IFRS** (for PIEs):
 - **A reality since 2005 for ~8,000 large groups in the EU**
 - Thorough EU endorsement process ⇒ strong ownership
 - Outside the EU: impediments due to **institutional capacity** constraints
- » **Implementation is a continuing challenge:** standards require improvements, enforcement, etc.
- » **National standards** continue to prevail for **annual accounts** and **non-listed companies**, under a common framework (4th and 7th directives), and with gradual alignment to IFRS
- » Call for **further harmonization and simplification**

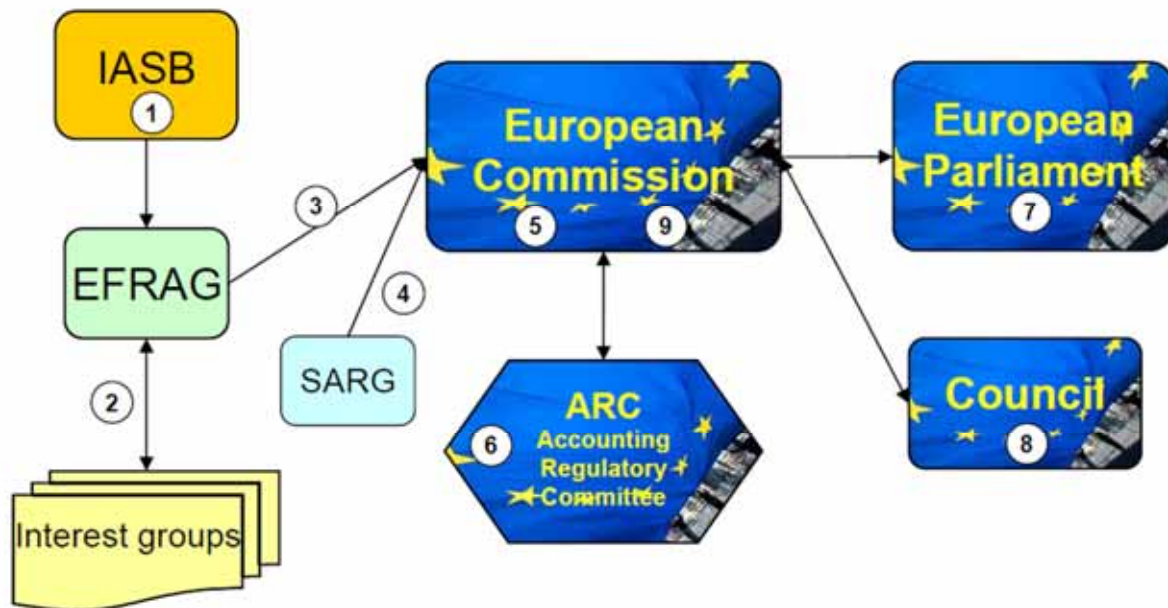


- » Regulation 1606/2002 (**IAS regulation**)
- » **Companies listed** on EU regulated markets must apply **IFRS as endorsed in the EU** for their **consolidated accounts**, starting in 2005
- » Options given to member states
 - may require or permit use of IFRS in **annual accounts of listed entities** – Czech Republic, Greece, Ireland, Italy and UK
 - may require or permit use of IFRS in **consolidated accounts of non-listed entities** – Austria, Czech Republic, Denmark and France
- » All member states maintain **national standards**
- » **IFRS for SMEs**: no plans for the EU to endorse for the time being, but under discussion

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A framework for financial reporting obligations





Source: European Commission

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- » **Financial instruments:** the main “un-endorsed” items
- » Area considered **sensitive**, all the more since the global financial crisis
- » IASB’s proposed approach to impairment
 - **Simplify** classification and **clarify** methodology
 - Maintain a “**mixed-attribute**” model (fair value + amortized cost measurements)
- » EC has **postponed endorsement of IFRS 9** (Phase 1 of financial instrument /replacement of IAS 39 project) **until the whole project is completed**

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- » 2 studies by the EC based on 2005 and 2006 accounts based on samples of financial statements
- » Objectives: to **evaluate the application** of IFRS by EU companies
- » Conclusions are **positive overall**, with noted improvements in 2006 v. 2005
- » 99% of F/S analyzed included a statement of compliance with EU-endorsed IFRS (v. 87% in 2005)

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- » Specific issues/findings:
 - Accounting policies: tendency to use standard (“boilerplate”) wording, especially for smaller entities
 - Consistency and comparability across countries and sectors: presentation and disclosures formats, vocabulary
 - IAS 16 and 38: useful lives
 - IAS 32 and 39: insufficient disclosures

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Main challenges in IFRS implementation (1)



» The **standards themselves**

- The crisis was the first real-life test – G20 has called for improvements –being addressed by IASB
- Fair value is a challenge
- Moving target

» Endorsement process – ability for countries to convey their views

» Scope of IFRS requirement

- **Tendency to “overprescribe” IFRS**
- A drain on local capacity
- Limited usefulness of complex financial information

» Multiple sets of standards add to complexity

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Main challenges in IFRS implementation (2)



» **Education/capacity** - investment in capacity building is insufficient or missing; consistency and quality of application

» **Enforcement mechanisms** are frequently absent or not efficient

» **Potential indirect effects**

- Taxation
- Loan covenants
- Dividend distribution

} Annual accounts mainly

» **Conversion process challenges** at the level of an entity and for regulators and users

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» **Planning and time management**

- Conversion projects started too late - insufficient time dedicated to the preparatory phase
- Lack of planning for changes in IT systems and processes
- Lack of preparation for the unexpected. Contingent time and resources should be planned for issues unknown at the onset of the IFRS project
- Focus on short-term impacts as opposed to long-term ones

» **Expectations gaps**

- Hope for rapid solutions to complex problems using “ready-to-use” tools
- Underestimating the impact on the notes to the F/S

» **Lack of internal knowledge** and expertise in IFRS / overreliance on consultants and auditors

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- » **Phased approach essential**
- » **Necessity of measuring all impacts on all tax, regulatory, business process and systems**
- » **Complex project involving several teams and departments in a company**
- » **Importance of preparation and change management**
- » **Importance of acquiring and/or building in house knowledge**

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- » IFRS being improved based on the lessons of the crisis
- » Post-crisis projects
 - Financial instruments (IFRS 9)
 - Leases
 - Consolidation (IFRS 10, 12)
 - Insurance contracts
 - Fair value measurement (IFRS 13)
 - Employee benefits
- » Convergence with US GAAP
- » IASB Governance
- » Moving toward a truly global set of standards



- » EC intent on developing proposals:

What is needed more

- Accounting tailored to needs of users
- One-stop-shop reporting
- Reduction of administrative burden



European Commission
Internal Market & Services DG



- » Currently **not endorsed** in the EU
- » **Inconsistencies with EU 4th and 7th directives**, per an EFRAG survey:
 - Extraordinary items
 - Financial instruments at fair value – fallback option to IAS 39
 - Useful life of goodwill (10 years)
 - Negative goodwill – recognized immediately
 - Uncalled capital – deducted from equity, not an asset
 - Impairment loss on goodwill – prohibition to reverse
- » **Revision of the directives under way** – may eliminate some of the differences – proposal expected in June 2011
- » **Some member states have already voiced strong opposition to endorsement**

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Thank you for your attention.

Questions?

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